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TAGS: EFIN ECON CH
SUBJECT: SHENZHEN STOCK EXCHANGE STARTUP BOARD TO OPEN IN AUGUST

¶1. (SBU) Summary: The Shenzhen Stock Exchange's much delayed new board for start-up companies should open sometime around the Beijing Olympics in August. The board, which will benefit some smaller firms that find it difficult to raise capital due in part to Beijing's limits on bank lending, has strict requirements for listing companies. However, some experts believe that the opening of the board could be delayed further if market volatility continues or as one observer said, in this instance, "the government can wait it out." End summary.

Opening Around the Olympics

¶2. (SBU) The Shenzhen Stock Exchange may soon get the final go-ahead to establish the much delayed new board for start-up companies. Wenhua Dai, the Shenzhen Stock Exchange's Deputy General Manager, told us March 17 that the new board had received central government approval. After a public comment period, it should be operational around the time of the Olympics. First proposed by the Shenzhen Stock Exchange in 2000, the final decision on the timing of the board's opening will be made by China's financial regulatory board, the Chinese Securities Regulatory Commission (CSRC). The official reason given for the most recent delay was to allow time for public comment. This should take two-to-three months and is one of the last steps in a complex approval process.

Financing for SMEs

¶3. (SBU) Jane Wu, the Shenzhen Stock Exchange's deputy director for strategy and international relations, explained to us that the new board, sometimes called a "NASDAQ-like" board, is intended primarily to encourage innovation in the Chinese economy. It will also benefit some smaller firms that are finding it increasingly difficult to raise capital in the face of Beijing's efforts to control liquidity. Many smaller companies depend on commercial bank loans for financing and have been affected by recent restrictions on such lending. The Shenzhen Stock Exchange already has a Small and Medium Enterprises Board, which was established in 2004, but its listing requirements are the same as the main board's. The new board should give more small and medium enterprises another option for raising capital.

Strict Requirements

¶4. (SBU) Although generally less rigorous than requirements for the main board, the Chinese government will set strict limits on the types of companies allowed to join the start-up board. To qualify,

start-ups must have at least RMB 10 million in profits for two consecutive years, or RMB 5 million in profits plus total revenue of RMB 50 million in the past year. (Companies seeking to join the main board must show revenues of at least RMB 30 million for three consecutive years.) The CSRC also requires--or "strongly encourages"--that companies joining the new board focus on a single business sector, preferably some type of innovative technology with high growth potential. The CSRC has discouraged companies whose products have long-term research and development requirements from listing, fearing they won't produce the best returns for investors, Wu said.

¶5. (SBU) Another restriction for the new board is on the number of shares made available for trading. Currently, the main board has a 100-share minimum for trading. The start-up board will have a 300-share minimum. Also, the lockup period (during which investors cannot sell their shares) on the start-up board is shorter: one year for investors who come in pre-initial public offering (IPO), and three years for the company's founding shareholders. On the main board, an investor's money is locked up for three years without exception.

More Volatility, Further Delays?

¶6. (SBU) Some experts say the delays in establishing the new board are due in part to current turmoil in financial markets that could further postpone its opening. Wu pointed out that the Chinese government keeps tight control on which companies can be listed on the main Shenzhen board to preserve the market's value. When the main Shenzhen board opened, one senior official predicted it would list 1,000 companies within three years. However, there are fewer than 500 companies listed on the main board, with few prospects of

significant increases in the near future. There have been no new listings on the main board since 2000. Wu explained that many companies exceed the regulatory requirements for listing, but the CSRC cherry-picks the best ones for listing in an attempt to guarantee ever-increasing stock prices. Professor Wu Lifan, a finance expert at Guangzhou's Sun Yat-Sen University, told us March 27 that government officials feel personally responsible for the performance of companies they approve to join the stock exchange. "It's not a free market," Professor Wu said. "Government officials are more concerned with their own stability than market stability."

¶7. (SBU) Shenzhen's composite index is down some 30 percent from its high for the year in mid-January, but Shenzhen Stock Exchange's Jane Wu argued the threat of an American recession would have a limited impact on the new board. She pointed out that overall the Chinese market is still fairly insular. Nevertheless, given the Chinese authorities' political concerns about keeping stock prices high, the opening of the new start-up board of the Shenzhen Stock Exchange could be further delayed until market conditions improve. Sun Yat-Sen University's Professor Wu said the board would likely not open while volatile markets have the potential to drive prices down and threaten social stability. "The government can wait it out," he said.

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